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DEPT PASS TO TREASURY FOR OFFICE OF SOUTH ASIA MNUGENT
TREASURY PASS TO FRB SAN FRANCISCO/TERESA CURRAN

E.O. 12958: N/A

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SUBJECT: RESURGENT RAJASTHAN: EFFORTS TO PUT THE STATE ON INVESTMENT
RADAR SHOWING SUCCESS

Reftel A: New Delhi 2666 B: New Delhi 2110

11. (SBU) Summary: An economic reporting trip to bellwether state, Rajasthan, in late September, indicated strong government implementation of infrastructural and educational improvements (reftel A). The trip also demonstrated that the Government of Rajasthan's efforts to attract new manufacturing and IT industries to Rajasthan is working. Major foreign companies have chosen Rajasthan to expand their presence in India, drawn by improved infrastructure, a trained labor pool, and Rajasthan's proximity to India's northern market. Innovative land acquisition policies and streamlined bureaucratic requirements have been welcomed by new investors and old. Business interlocutors were complimentary of the improved business and investment climate in the state and were very upbeat on Rajasthan's growing business opportunities. End summary.

Rajasthan Undergoes Major Investment Push

12. (SBU) Having worked to get the basics right in infrastructure and education, government and private sector interlocutors alike told Econoffs during their visit September 23-25 that the current Rajasthan government has undertaken a major push in the last 18 months to bring in significant foreign investments and put Rajasthan on the map for investment. The results so far are impressive: the state has attracted Honda to set up its second auto plant in India, along with new facilities by French glassmaker St. Gobains, construction materials company Lafarge, and IT companies such as Infosys and Genpact. Honda's choice of Rajasthan for its second automotive plant in India was mentioned by nearly every interlocutor in Jaipur as a major accomplishment. Industry Secretary Sampatram claimed that Honda's decision had reassured other smaller Japanese companies to choose Rajasthan, and that several had already started purchasing land. A recent investment promotion conference, titled Resurgent Rajasthan, yielded 300 signed memoranda of understanding and letters of intent with investors that could result in as much as \$40 billion in investment.

Incentives Don't Matter To Companies; Basics Do

13. (SBU) Both Industry Secretary Ashok Sampatram and Bureau of Investment Promotion Commissioner Umesh Kumar observed that the government in 2003 had switched from industry promotion to investment promotion. Sampatram explained that an industry policy is inherently problematic because different industries need

different help and there is no one size that fits all. Further, he maintained, offering incentives does not work because it is not what most companies base their decisions on. That is because most incentives only last 4-5 years, but investment decisions are for decades. Instead, he claimed, investors look to infrastructure, power, telecom, law and order and labor relations. Easy clearances are also a major attraction, according to Sampatram, a goal the government is working on. He cited as an example that Deutsche Bank was able to move into its new premises within six months of approaching the government for permission to set up a new building.

¶4. (SBU) Umesh Kumar of the Bureau of Investment Promotion noted that his five years of experience being the Joint Secretary for the Ministry of Commerce's Department of Industrial Policy and Promotion (which oversees national investment policy) had helped him understand that incentives are not important to foreign investors. He claimed that if concessions mattered the most, then the states with the most generous concessions - Himachal Pradesh, Uttarakhand and Jammu & Kashmir - should have the highest investment rates, but they don't, he noted. Instead, the Government of Rajasthan works on the issues that worry companies - for example, land acquisition and infrastructure.

¶5. (SBU) Kumar is also trying to improve GoR's bureaucratic responsiveness to investors. He notes that a "single window" of clearances does not really work, because it assumes a transfer of power from all the other approving agencies to just one agency, but that hasn't been achieved in any state. Instead, Kumar has proposed an electronic single window - a portal - where a company can input all its relevant information just one time, after which the portal sends it to all the concerned departments. Individual approvals

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will still be necessary, he conceded, but the business will not have to spend time going physically to each place. His idea of an e-window would also create one single ID for the company across all the government agencies, rather than separate file numbers, making it less cumbersome for the business.

¶6. (SBU) Another innovation that Kumar has just started is the notion of reverse incentives - he is convincing new investors to give the government of Rajasthan 5% equity in projects, so that the investor is in essence paying the GoR to be able to invest, rather than the state paying the investor in incentives. Kumar stressed that the government receives no role on the board of the company and thus has no leverage in the company's decisions. In exchange, the government is leasing state-owned land, rather than selling it outright, which lowers the upfront cost to the company.

Proximity to Northern Market

¶7. (SBU) Kumar observed that Rajasthan is not a big consumer market; because of its large land size, it is really several fragmented markets, by themselves not worth servicing. However, he noted, Rajasthan is close to New Delhi and the National Capital Region (NCR), which also includes the fast-growing and affluent suburbs of Noida and Gurgaon. His plan is to attract manufacturing companies to eastern Rajasthan, closest to the NCR markets to serve the Delhi market. Meanwhile, he sees Jaipur as a good choice for services-based businesses, because it has the social amenities, including schools and colleges, to attract IT and related companies.

¶8. (SBU) Rajasthan's proximity to the NCR has emboldened the GoR to start approaching businesses to invest in Rajasthan. Kumar stated that he sent a team down to French glass maker St. Gobain's factory in Chennai, when he heard they were looking to set up a second factory to serve the northern market. Glass' fragility requires that companies set up close to markets and Kumar's team was able to convince the company to locate in Rajasthan. Similarly, the Bureau of Investment Promotion has approached garment manufacturers in the Delhi region to expand by coming out to eastern Rajasthan. The team also encouraged the manufacturers to create a special purpose vehicle (SPV) to join in together and buy land and source electricity and water together as a unit, rather than individually.

The result, according to Kumar, was that 18 companies have agreed to start up new production in Rajasthan and provide employment to 25,000 people. Rajasthan's proximity to consumer markets in Northern India is expected to be even closer after completion of the planned Delhi-Mumbai freight corridor, of which 30-40% is expected to run through eastern Rajasthan.

Land Policy Enables Smoother Industrialization

¶9. (SBU) The state government appears to be drawing lessons from other states' highly publicized land acquisition woes. Sampatram noted that the GoR had begun a new land policy where there is no forcible acquisition of land. (Note: In July 2008, per Reftel B, contacts reported GoR misuse of land acquisition initiatives, in which prime real estate was purchased below-market prices or confiscated from farmers, although it is unclear whether they referred to the old or new land policy. End note.) In addition, compensation is based on rates determined by local district committees. In projects near Rajasthan's largest cities, landowners who sell will be able to receive one-fourth the size of their sold landholding in nearby commercial and residential land in a landswap. The landowner receives the new land on the outskirts of the project site, which allows the project developer to obtain the contiguous land it needs, while giving the landowner new land close by the project, ensuring an appreciating land asset.

Private Sector Welcomes Improvements

¶10. (SBU) Members of Rajasthan's Federation of Trade and Industry appreciated the steps the state government has taken to improve the business environment in the state. Members told Econoff that the Chief Minister is doing well for corporates and makes decisions to

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get things going. They see the Raje government as adopting modern practices and "professionalizing" the bureaucracy. They noted that the current focus is infrastructure, roads and private education.

¶11. (SBU) Gems and jewelry businessowners had different perspectives on the current economic outlook, depending on the size of their export operations. Ashok Goyal of Dwarka Gems, a large jewelry designer and exporter which employs nearly 400 people, explained that his business is large enough and has sufficiently large margins that the stronger rupee and removal of US Generalized System of Preferences (GSP) privileges last year did not hurt his company. He sees a big opportunity for his company and Rajasthan in the global gems and jewelry market. He noted that the US used to be the biggest market, but his company is focusing more on Europe, especially Italy, now. His company is also working more with European designers, who are sourcing more of finished jewelry from India, as they close down manufacturing units in Europe because of labor costs. Goyal finds the infrastructure to be sufficient to his needs and better than Delhi's, the bureaucracy fine to work with, and labor availability very good.

¶12. (SBU) The Gem and Jewellery Export Promotion Council provided a different view, noting that most of its 1000 members were smaller companies that operated on small margins that were eroded by the prevailing higher global gold and silver prices. Sanjay Singh, Regional Director, noted that the big fluctuations in the rupee exchange rate over the past year have created uncertainty in buyers and most of the Council members were too small and inexperienced to hedge their foreign exchange transactions. However, even with those difficulties, Singh described strong growth in Jaipur's jewelry industry. He noted strong participation by jewelry firms in several government-sponsored industrial parks, including a Special Economic Zone that was sold out within 48 hours. In response to the growth of gem and jewelry businesses and the need for more employees, the council is sponsoring the creation of an Indian Institute of Gems and Jewelry in Jaipur, focused on design and manufacturing. The building is currently under construction and targeted for completion by 2009.

¶13. (SBU) Singh opined that the loss of US GSP was a setback to

many smaller jewelers. He explained that the removal of GSP meant a new imposition of 6% import duty, yet most of his members operated on margins of just 3-4%. Small companies have switched to other foreign markets or to the domestic market. But operating in the world markets faces another challenge, according to Singh: the world demand for gems and jewelry is not growing and the sector is facing competition from white luxury goods, which could prompt some consolidation in the market.

¶14. (SBU) US-based BPO Genpact has been in India for ten years and branched into Jaipur about five years ago. Diwakar Singhal, Senior Vice President, told Econoffs that when Genpact decided it needed to expand, most of the large metros were getting "full" and that employees were getting poached by other firms. The company considered 40 cities across India for a second office and decided on Jaipur, because the government was "quite supportive," and the city had a good education hub, reasonably good infrastructure, and low crime. He noted that Jaipur's heritage reputation was also helpful, as their mostly-foreign clientele appreciate the chance to have business meetings in a tourism destination. Singhal judged that the Rajasthani bureaucracy was of "good caliber", supportive and overall "clean".

¶15. (SBU) He identified talent as a challenge, as Genpact currently employs 2500 people in Jaipur and plans to build a third facility in a Rajasthan SEZ next year. He conceded that there was good raw talent locally, but that Genpact had to "upskill" the graduates and provide corporate cultural training. He also pointed to several collaborations they are doing with training institutes. On the positive side, Singhal noted that attrition in their Rajasthan facilities is only half that of the industry average. Another advantage of smaller cities that Singhal identified is that of lower wages than cities like Bangalore or Hyderabad. He said that Genpact expected revenue growth to be 26-28% in the current fiscal year.

¶16. (SBU) Members of the Jaipur chapter of the Confederation of Indian Industries (CII) echoed many of the themes that other

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businesses had sounded and identified IT services, tourism, and the planned Delhi-Mumbai freight corridor as large business opportunities. CII members representing industries from heritage hotels to Vodafone to Bosch Auto Components agreed that the government of Rajasthan was increasingly pro-active in industrial development and infrastructure, with improved infrastructure and land acquisition assistance. They noted with approval that consecutive governments in Rajasthan did not "undo good work" being undertaken by the bureaucracy and allowed the continuation of good projects.

¶17. (SBU) Bosch Vice President Dinakar Murthy-Krishna explained that during the ten years they have been in Rajasthan, the government has done well to improve the trained labor pool, with a number of training institutes and public-private partnerships. He feels that GOR officials are very professional and transparent in their dealings, especially when compared to the Maharashtra government. Infrastructural improvements are occurring very rapidly and Bosch is in the midst of building another plant in Rajasthan. Vodafone's Legal Head, Pradeep Mehra, reiterated Murthy-Krishna's points, observing that the bureaucracy is open and receptive and has been pro-active in improving roads, water, and electricity. He noted that people are returning to Rajasthan because they see the opportunities. He was pleased that 12 private universities are being established in Rajasthan.

Comment

¶18. (SBU) A professional state government bureaucracy and sound and consistent policies have yielded higher economic growth and employment opportunities in Rajasthan. Rajasthan registered a remarkable compounded annual growth rate of 15.2% between 2002-03 and 2006-07, nearly doubling its GDP in the process and raising Rajasthan from near the bottom of the pile to India's eighth largest state economy. As the large Tier-1 metros become tapped out of affordable real estate and labor, Tier-2 cities like Jaipur become

increasingly viable, if infrastructure and education are put in place. Rajasthan's cities demonstrate that there is another chapter in India's growth story unfolding and proper state policies can write new destinies. Rajasthan is also benefiting from its proximity to India's northern market - demonstrating the strong economic engine that the country's large domestic market can spark in new regions of the country. As Rajasthan continues to show up on investors' radars, that spark is likely to expand in tourism and hospitality, manufacturing, education and Rajasthan's more traditional industries like textiles and mining.

¶19. (SBU) The improving business environment, strong growth and responsive government policies bode well for the incumbent Bharatiya Janata Party as it prepares for state assembly elections on December ¶4. A few months ago, the GoR appeared to be in trouble as it faced a growing communal rift as communities quarreled with one another over economic benefits based on caste. The GoR has successfully defused that issue and instead managed to make governance and development important campaign issues.

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